Directorate of
Intelligence

~~Secret~~

25X1

File Copy

do not remove

5 art

22 grafs

International Economic & Energy Weekly

25X1

15 March 1985

~~Secret~~

DI IEEW 85-011
15 March 1985

Copy 682

Page Denied

Sanitized Copy Approved for Release 2011/03/02 : CIA-RDP97-00771R000707440001-0

25X1

[redacted]

International Economic & Energy Weekly [redacted]

25X1

15 March 1985

iii	Synopsis	
1	Perspective—LDC Debt Issues: What's Ahead [redacted] 25X1	
	[redacted] 25X1	
3	Briefs	Energy International Finance Global and Regional Developments National Developments 25X1
11	Philippines: The Reluctant Road to Economic Reform [redacted]	
	[redacted] 25X1	
17	Japan: Competition in Semiconductors To Intensify [redacted] 25X1	
	[redacted] 25X1	
23	Proposed Soviet Gas Pipeline to Eastern Europe [redacted] 25X1	
	[redacted] 25X1	
27	Cuba: Castro Struggles With the Economy [redacted] 25X1	
	[redacted] 25X1	
33	LDC Financial Developments: Monetary Data as an Early Warning [redacted] 25X1	
	[redacted] 25X1	

[redacted] 25X1

25X1

Comments and queries regarding this publication are welcome. They may be directed to [redacted] *Directorate of Intelligence* [redacted]

25X1

[redacted]

International Economic & Energy Weekly [redacted] 25X1

Synopsis

1 **Perspective—*LDC Debt Issues: What's Ahead*** [redacted] 25X1

We believe that further cooperation among creditors and debtors and favorable world economic conditions are necessary to maintain the progress made thus far. [redacted] 25X1

11 **Philippines: The Reluctant Road to Economic Reform** [redacted] 25X1

Although they have completed negotiations on a financial rescue package, creditors and aid donors continue to pressure Manila to make even greater reforms to stimulate economic growth and restore financial stability over the long term. President Marcos's political needs and the intransigence of Manila's technocrats, however, suggest that such negotiations will be lengthy and difficult and that implementation will be slow. [redacted] 25X1

[redacted] 25X6

23 **Proposed Soviet Gas Pipeline to Eastern Europe** [redacted] 25X1

The Soviets are pushing for an agreement with East European countries on the joint construction of a new gas export pipeline. Moscow wants to get more East European participation in Soviet investment projects in return for increased Soviet deliveries of energy and other raw materials. [redacted] 25X1

27 **Cuba: Castro Struggles With the Economy** [redacted] 25X1

President Castro's recent call for new economic priorities and at least another 15 years of economic austerity reflect Cuba's concern over mounting economic problems as well as its sensitivity to sharp Soviet criticism of Havana's economic mismanagement. [redacted] 25X1

33 **LDC Financial Developments: Monetary Data as an Early Warning** [redacted] 25X1

Central bank data appear to be good indicators of changes in domestic and external financial conditions and evidence of policy behavior in financially troubled countries. [redacted] 25X1

 25X1

International Economic & Energy Weekly

25X1

15 March 1985

25X1

Perspective

LDC Debt Issues: What's Ahead

We believe that further cooperation among creditors and debtors and favorable world economic conditions are necessary to maintain the progress made thus far. Although many financial observers are optimistic about the LDC debt situation, we believe that the international financial system will remain under stress for the next three to five years because of LDC foreign payments troubles. Even this year could bring problems as some countries' difficulties in meeting IMF goals lead to noncompliance, a cutoff of new money, and increased creditor-debtor tensions. 25X1

A major reason for optimism about the LDC debt situation is the progress in easing the debt servicing burden for the major debtors. Twenty-three countries reached formal or tentative agreement on debt restructuring with commercial banks and Western governments last year, including major debtors such as Mexico, Brazil, Argentina, Venezuela, the Philippines, and Yugoslavia. The amount of debt covered in the restructurings was a record $115 billion and included obligations due not only in 1984 but over the period 1981-90. The agreements for some major debtors, however, including Mexico, Brazil, Argentina, Venezuela, and the Philippines, have yet to be signed. 25X1

Creditors—particularly commercial banks—made a number of concessions. The most important development was a multiyear restructuring for Mexico, in which debt maturing in 1984-90 was spread out over 14 years. Venezuela, Ecuador, and Poland also obtained multiyear agreements. In addition, overall restructuring terms were more favorable during 1984 than in 1983. 25X1

Through a series of meetings, Latin American countries applied persistent but moderate pressure on creditors for additional debt solutions. At a meeting in Cartagena last June, 11 nations formed the Cartagena Group as a political forum to voice Latin concerns. Currently a major goal of the group is to arrange a political dialogue on debt among the highest levels of Latin and industrial country governments. 25X1

The flavor and results of the Cartagena process to date suggest that Latin debtors will continue to support joint action so long as it does not threaten their ability to negotiate individually with creditor banks and governments. Latin debtors are now more willing to press for changes in the policies and operations of official and private Western institutions. We believe that debtors perceive

their forum as being largely responsible for concessions they received from commercial banks last year and probably will continue to press for concessions at the IMF/IBRD committee meetings in April. [redacted] 25X1

In our judgment, the major challenge to the international system in 1985 will be debtor failure to comply with IMF-supported programs and associated creditor reluctance to lend new money. Slower export growth, industrial country protectionism, and continued high real interest rates also will be key issues. Moreover, because these problems may prevent debtors—particularly the Latins—from repeating the progress made last year, new democratic governments will come under increased pressure, and the tone of the Cartagena Group pronouncements may become more strident. [redacted] 25X1

Briefs

Energy

Interest Revived in Iraq-Jordan Pipeline

[redacted]

Iraq's Deputy Oil Minister acknowledged that an oil pipeline proposal is again under active consideration by Iraq and Jordan, according to the US Embassy in Baghdad. The principal US construction firm involved in the project is preparing a final offer for presentation to Iraqi officials in the next several weeks. The offer will include a new financing proposal designed to address Iraq's insistence on guarantees against liabilities for payments and crude deliveries during a disruption in service. In particular, the Iraqis are insisting US financiers, contractors, and suppliers bear the risk of a disruption in construction or operation of the line by the Israelis or others. Baghdad's early demands has quashed optimism in the project, which Jordan has promoted vigorously. According to the US Embassy in Tel Aviv, a high government official has stated that Israel is prepared to guarantee it will not engage in an unprovoked attack against the pipeline provided there is unspecified US involvement. Despite the flurry of activity, we believe Baghdad is concentrating on ongoing negotiations with Riyadh on a separate pipeline to the Red Sea. If these talks break down, however, Iraq is likely to pursue more seriously the Jordanian option. [redacted]

25X1

25X1

Indonesia To Market New Crude

[redacted]

Indonesia is introducing a new grade of crude oil for export to gain pricing flexibility without formally breaking OPEC guidelines. [redacted] Pertamina will begin marketing the new "Sumatran Medium"—a mix of light crudes, including its benchmark, Minas crude—in April. Pertamina plans to sell the new blend at $27.40 per barrel—compared with the official OPEC price of $28.50 per barrel for Minas crude. Pertamina will limit sales of Minas under the new label to 100,000 b/d, roughly one-third of output from the Minas field, until market reaction to the new crude can be assessed. [redacted]

25X1

25X1

25X1

25X1

[redacted]

25X1

Pakistan Buys More Oil From Iran

[redacted]

Pakistan has agreed to increase its purchases of Iranian oil, from 10,000 b/d to 20,000 b/d as of last fall, for a one-year period to regain a major export market. The increased oil imports probably will be offset by barter, eliminating the need for outlays of foreign exchange by either side. Pakistani exports to Iran decreased by about 65 percent during July-November 1984 compared with the same period in 1983, dropping Iran from its number-one position among Pakistani overseas markets to the number-seven position. Pakistan's poor wheat crop in 1984, inadequate quality of its manufactured goods, and Tehran's foreign exchange shortage all contributed to the downturn in Pakistan's sales. Additional oil imports from Iran along with increasing domestic production could lead to cutbacks in oil imports from Gulf oil states, [redacted] and perhaps cause some friction between Islamabad and the Gulf supporters of Iraq. [redacted]

25X1 25X1 25X1

International Finance

Mexican Debt Rescheduling Update

[redacted]

Mexico's $48 billion debt rescheduling agreement was submitted this week to the country's 530 bank lenders for review, seven months after the original package was negotiated. [redacted] Final approval, targeted for 29 March, still could be jeopardized if an IMF agreement is not reached quickly. Mexico City and international bankers plan to ask the United States to intercede with the IMF next week if agreement with the Fund is not reached by then. [redacted]

25X1 25X1 25X1

France Encourages Use of ECU

[redacted]

In a move intended to encourage commercial use of the ECU, Paris decided last week to allow importers to engage in forward currency contracts to cover anticipated imports that are denominated in European currency units (ECUs). The French hope the ECU will eventually rival the dollar as both a reserve asset and a transaction currency. By buying foreign currency to pay for contracted imports before the actual import takes place, importers will now be able to protect themselves against exchange risks. The measure does not discriminate per se against imports by origin but will probably favor imports from other European Monetary System members whose firms are more likely to offer ECU-denominated contracts. The government had forbidden such "forward cover" in 1981 when the franc was under pressure, and the eased access probably reflects the recent improvement in the French balance of payments. [redacted]

25X1 25X1

Global and Regional Developments

Gold Lures Mining Dollars

[redacted]

Planned capital investment in worldwide mineral projects has increased for the third consecutive year, according to results of a new mining industry survey. Gold continues to be the most attractive metal in terms of the number of

25X1

projects planned. According to the survey, 137 gold projects are either under construction, have a firm development program, or are in the initial proposal stage. This is more than double the number of gold projects planned two years ago and compares with 88 copper, 64 aluminum, 40 lead and zinc, and 33 iron ore projects. Industry analysts, however, expect low mineral prices to keep some of the projects on the drawing boards and postpone completion dates on others. Continued investment in gold has unquestionably come at the expense of base metals. Despite gold's steady price decline—from $405 per ounce in March 1984 to $287 in early March 1985, gold mining is still profitable for many producers—industry analysts claim that prices could drift even lower without quashing gold fever. New processing technologies have significantly reduced operating costs, improved gold recovery rates, and allowed for the exploitation of lower-grade ores. [redacted] 25X1

National Developments

Developed Countries

[redacted]

25X1

[redacted]

25X6

[redacted] 25X6

Dollar Fuels West German Inflation Worries

[redacted]

The dollar's first-quarter surge against the deutsche mark—up about 10 percent from the end of last year—will boost West German import prices, albeit with a lag, and heighten Bonn's concern that the strong dollar could eventually re-ignite domestic inflation. Imports—about one-third are denominated in dollars—represent roughly one-third of GNP. Although West Germany's overall inflation rate remains low—just 2.1 percent year over year in January—accelerating import price rises this spring could increase pressure on Chancellor Kohl to take a tougher line on the dollar problem at the summit. [redacted] 25X1 25X1

France's SNECMA—Expanded Commercial Markets?

[redacted]

SNECMA, the French Government–owned aircraft engine manufacturer, is negotiating with General Electric to expand its commercial engine business through shared development of the unducted fan (UDF), an advanced fuel efficient propulsion system that is being supported by NASA. Although the program would broaden *SNECMA's* technology base, commercial success is far from certain. The UDF, one of two NASA-backed propulsion systems, is aimed at fuel savings of up to 25 percent. US and European airlines have expressed interest in UDF-powered aircraft as replacements for their aging short-range fleets. This interest may be a way to postpone decisions on the Airbus A-320, [redacted] Unanswered technical questions have raised concerns about the timing and viability of the UDF program. Any new aircraft design using this technology will likely be delayed past 1987, and we believe the earliest operational date will be in the latter half of the 1990s. [redacted] 25X1 25X1 25X1

New Airbus Industrie Managers Face Problems

[redacted]

The appointment of France's Jean Pierson and Johann Schaeffler of West Germany to the two top positions at Airbus Industrie (AI) caps a monthlong struggle among the consortium's governments over management structure and financial control and marks the first time a West German has been named to a key operating post. Aircraft manufacturers are facing lackluster demand throughout the West, and AI has been forced to stretch out existing programs—and to lay off some workers. Airbus is also concerned that the Pan American strike could jeopardize the large sale of the all-new narrow-body A-320. In Western Europe, airlines continue to delay narrow-body purchases, citing the impact of changing engine technology on new designs, [redacted] In turn, slow sales by AI may delay development of the TA-11 long-range aircraft, which is needed to fill out the consortium's product line. [redacted] 25X1 25X1 25X1 25X1

Less Developed Countries

South Korean Reaction to Trade Deficit

Seoul has announced measures to slow imports and boost exports that may presage stronger action in the wake of a $1.1 billion trade deficit in the first two months of 1985—nearly double the same period in 1984. South Korean economic planners have projected only a $300 million deficit for 1985. Seoul's plans include encouraging import substitution in machinery and livestock feed, reducing oil imports by curbing passenger car use, and jawboning trading partners to further open markets to Korean exports. Continued poor trade performance will strengthen opponents to import liberalization who advocate strong measures such as the government's discretionary tariff and quota powers. In our judgment, however, Seoul will temper its actions before President Chun's US visit in April. In addition, Seoul places high priority on rapid subscription to the $815 million in loans currently on international credit markets and will carefully monitor foreign bankers' reaction to its deficit reduction policies.

25X1

25X1

Thailand Considers Countertrade

Bangkok is studying the possibility of requiring a reciprocal purchase provision in all government contracts with foreign suppliers, and recommendations are due to the Cabinet by the end of March. Although Thailand has conducted barter trade with Eastern Europe and South Korea in the past, it has generally conducted trade multilaterally. Bangkok's troublesome trade deficit, however, has led to a reconsideration of countertrade. Thai policymakers, moreover, fear the loss of commodity export markets to neighboring Malaysia, which is stepping up its use of countertrade. Nonetheless, the inefficiencies of barter—if adopted as government policy—would probably offset much of the favorable effects of last year's devaluation on Thailand's medium-term export prospects.

25X1

25X1

Nigerian State Budgets Feel the Pinch

Nigeria's 19 state governments, which depend on allocations from the Federal Government for about 80 percent of their revenue, have had to make drastic cuts in public services, defer capital projects, and reinstitute some local taxation to cope with smaller disbursements from Lagos. During the oil boom days under the last civilian regime, most state governments eliminated internal taxes, accumulated large debts, and spent their share of the oil revenues flowing from Lagos with virtually no accountability. Currently 35 percent of federal funds is earmarked for the states under a complex revenue sharing formula. This year, however, the Federal Government plans to deduct payments due from the states on their internal and external debts before dispensing funds. The oil-producing states, which had received an additional 3.5 percent of the total federal allotment for all 19 states, are now entitled only to the 3.5 percent of revenue that accrues from onshore oil production. This means a smaller share for the oil states, all located in the south, and is likely to aggravate resentment of the northern-dominated military government.

25X1

25X1

Zanzibar's Clove Sales

After a four-year hiatus in trade, Indonesia and the Government of Zanzibar recently concluded an agreement for the Indonesian purchase of 6,000 metric tons of cloves, totaling $18.3 million. In return, Zanzibar will purchase 15,000 tons of Indonesian rice, the island's staple food. The low clove price of $3,050 per ton—a marked drop from the original asking price of $5,200 per ton—reflects Zanzibar's loss of near-monopoly power in the clove market. Inflated price expectations and poor marketing have undermined its export market, and Zanzibar has no other prospective buyers for its remaining clove stock of 11,000 tons. Cloves account for 90 percent of Zanzibar's export earning. Dim export prospects will hamper Zanzibar's ability to pay for vital food imports. In 1980 the export price of $9,000 for each ton of cloves bought 40 tons of rice; at current prices, 1 ton of cloves buys only 11 tons of rice.

25X1

25X1

Panama Moves Against Money Laundering

Panamanian authorities seized First Interamericas Bank on 1 March for involvement in the laundering of drug money, the first such action taken in Panama. First Interamericas is owned by a Colombian trafficker, who is under arrest in Spain and may be extradited to the United States. On 28 February the government-controlled press charged Banco Ganadero and Banco Cafetero, Colombian branch banks, with money laundering.

25X1

25X1

Seizure of the two Colombian banks would let the Panamanian Government, which publicly admits to only two or three dirty-money banks, claim its financial sector has been purged of drug money laundries. This would shield major launderers who have arranged safe entry of their funds with Panamanian customs and the Panamanian Defense Force and who operate through other banks in Panama that welcome their business.

25X1

Communist

Poland's IMF Membership

An IMF technical team held talks with Polish officials last month as the first step in processing Warsaw's application to rejoin the organization. The delegation—the first since the United States lifted its opposition to membership—found the balance-of-payments data to be generally in line with IMF practices but recommended changes in some domestic calculations. Another team is scheduled to arrive in mid-April to examine the current economic situation. Many Western financial experts doubt Poland will enter the Fund before the end of the year. The Polish regime remains divided on IMF membership. Supporters hope membership will help restore a flow of credits from Western governments and may believe it will facilitate economic reform. Opponents believe, however, that likely IMF insistence on a stabilization program represents undue interference in the country's economic affairs. Moreover, they may cite the recent popular criticism of modest price increases as evidence that Warsaw cannot heed IMF austerity demands. Underground Solidarity leaders recently said they would oppose any IMF program that

25X1

would cut living standards. The USSR, meanwhile, probably remains reluctantly in favor of membership in hopes that it could help Polish economic performance, or out of concern that a Soviet veto could lead to more Polish demands on the USSR. 25X1

East Germany's Borrowing Binge

A surge of medium-term borrowing has bolstered East Germany's financial strength giving East German economic managers greater flexibility than they have enjoyed in years. Since last June, East Berlin has raised about $1.4 billion in seven untied credits of four to seven years' maturity on increasingly favorable terms. The Bank for International Settlements reports that as of 1 October—before the five most recent loans—East German assets at reporting banks reached $4.6 billion, well in excess of normal liquidity needs. We expect East Germany to seek more medium- and long-term credits, using the proceeds to trim its still considerable short-term debt as it runs current account surpluses to gradually reduce total debt. We doubt reserves will grow much more. At the same time, East Berlin could be taking advantage of its improving creditworthiness to reduce interest expenses and forge closer links with some Western banks. East Berlin also may be planning a boost in capital goods imports to make up for the decline in investment in recent years. Although this will probably await completion later this year of the economic plans for 1986-90, we do not expect large hard currency trade deficits as in the 1970s. 25X1 25X1

Rapid Chinese Economic Growth

China last week announced that the value of its total industrial and agricultural production grew 14.2 percent last year and per capita income rose 15 percent. The value of production in 1984 increased 9.9 percent for agriculture, 45.5 percent for rural industries, and 14 percent for urban industries. Rapid economic growth was sustained by 8-percent increases in coal, oil, and steel production and a 6.6-percent growth in electric power. The 14-percent increase in urban industrial output is considerably higher than the 4- to 5-percent growth rate planned for 1984 and is being used by the leadership as evidence of the success of economic reforms. Beijing, however, is concerned that the rapid industrial growth and the sharp increase in personal income and savings—up 36 percent last year—will lead to inflation. Recent reports of widespread speculation and illegal price hikes suggest that the Chinese cost of living is rising faster than the official 2.7-percent rate. 25X1 25X1

Havana Pressing for Increased Trade With Japan

Although Havana has launched an aggressive campaign to improve its trade relations with Japan, we believe that a significant increase in bilateral trade is unlikely. According to the US Interests Section, Havana recently tried to impress a visiting Japanese delegation with Cuba's economic performance and prospects under its new export-promotion policy. At the annual meeting of the Japan-Cuba Economic Commission last month, Havana pressured Japanese business leaders to increase imports of Cuban merchandise to improve the trade balance, now running 2 to 1 in Japan's favor. Cuba also pressed for the creation of a $60 million joint export promotion fund, with the costs to be split 25X1

between Cuba and its Western trading partners, including Japan. Havana probably will repeat its hard sell during a high-level Cuban visit to Japan later this month. Export prospects are limited, however. Tokyo shows no willingness to renew long-term official export insurance for Cuba. Nickel exports are constrained by US prohibitions on imports of steel containing Cuban nickel. Moreover, poor quality and unreliable delivery continue to limit Cuban citrus and sugar sales. 25X1

Cuban Drought

According to the Cuban press, a major portion of the island has been suffering from drought since last May. Havana received only 60 percent of its normal rainfall last year, causing cutbacks in urban water supplies. In the rural areas, reports indicate that it has become impossible to provide sufficient water and food for livestock, increasing the risks of drought-induced diseases and blight. 25X1 To address the fodder shortage, a campaign is under way to collect sufficient residues from sugar and other crops to feed some 170,000 head of cattle. In addition, microdams have been built in streams at livestock enterprises. The drought also has reduced the output of tubers, tomatoes, and other foods, crimping Havana's ambitious new plan to produce more than 33 million quintales of food and vegetables this year. 25X1

Philippines: The Reluctant Road to Economic Reform

25X1

Although they have completed negotiations on a $10 billion financial rescue package covering 1985-86, creditors and aid donors continue to pressure Manila to make even greater reforms in agriculture, finance, and manufacturing to stimulate economic growth and restore financial stability over the long term. President Marcos's political needs and the intransigence of Manila's technocrats, however, suggest that negotiations on reforms will be lengthy and difficult and that implementation will be slow. Delays in economic restructuring would limit real growth to an estimated 1-percent annual rate, compared with a 4-percent growth rate possible by 1987 if the reforms are swiftly enacted.

The Creditors' View of Reform

For the past 18 months, Manila's international creditors and Philippine technocrats have concentrated on stabilizing the faltering economy by concluding a multiyear financial rescue package including some economic policy reforms. The package consists of an IMF standby loan, financing and rescheduling from commercial banks, and new loans and rescheduled debt payments from official creditors. The government's aid donors are now seeking a more durable solution to the country's financial problems. They are emphasizing far-reaching market-oriented policy and institutional reforms designed to improve agricultural and industrial productivity, as well as restructuring the financial sector and revising tax and public expenditure policies.

Manila's creditors believe the need for reform is clear from the Philippines' recent economic record. Despite economic growth averaging 6 percent annually during the 1970s, for example, over half the population still lives below the poverty threshold. Furthermore, surrounded by neighbors that are prospering with the world recovery, the Philippines remains the only economy in East Asia afflicted with falling real output; the debt crisis, aggravated by political unrest, precipitated a 5.5-percent decline in output last year and a 50-percent inflation rate.

25X1

Delays in moving ahead with reform will be costly to the economy. The World Bank believes that sustained commitment to structural adjustment and economic policy reform is necessary if the economy is to achieve a 4-percent annual growth rate by 1987. Otherwise growth will be limited to about 1 percent annually and living standards for the average Filipino will decline further.

25X1

25X1

The sector in the greatest need of reform is agriculture—which generates over a fourth of national output, provides a livelihood for more than two-thirds of the population, and accounts for 40 percent of export earnings. Manila's pricing and exchange rate policies have long favored urban consumers over farmers; as a result, farmers' real income fell 50 percent between 1977 and 1981.

25X1

Monopoly marketing institutions are an important part of the problem. The US Embassy reports that a coconut monopoly—comprising marketing, milling, exporting, and banking institutions controlled by Marcos's longtime political ally, Eduardo Cojuangco—is partially responsible for nearly halving coconut farmers' income between 1979 and 1983. Moreover, coconuts are a source of income for one out of three Philippine families, and AID studies conclude that basic marketing and pricing reforms could boost coconut farmers' income by about one-third.

25X1

25X1

Philippines: Real Production, 1979-84

Index: 1978=100

Sector	1979	1980	1981	1982	1983	1984 [a]	Share of 1984 GNP (*percent*)
Gross national product	**107**	**112**	**116**	**118**	**120**	**113**	**100**
GNP per capita	104	107	108	107	106	98	
Agriculture, forestry, and fishing	105	110	114	117	115	116	26
Coconuts	100	100	108	100	100	88	
Sugar	108	100	100	115	85	79	
Rice	103	111	113	118	103	108	
Industry	108	113	118	121	122	111	34
Manufacturing	105	110	114	116	119	112	
Services	106	112	116	120	125	121	40

[a] Preliminary.

[redacted] 25X1

The sugar industry, which accounts for approximately 8 percent of Philippine exports, is another monopoly dominated since 1977 by a longtime associate of Marcos, Roberto Benedicto. According to US Embassy reporting, Benedicto has exploited his control of NASUTRA—the national sugar marketing authority—to finance expansion of his sugar empire into milling, farm equipment, transportation, and banking. Philippine economists estimate since 1977 that his manipulation of the sugar industry cut $2 billion from revenues paid to local sugar producers. [redacted]

Manila's creditors also believe reforms are needed in the financial sector, which has been undercapitalized and recently plagued by failing private banks and deteriorating loan portfolios in the large government-controlled institutions. An increase in nonperforming loans, large deposit withdrawals, and high interest rates have so weakened private banks that in 1984 the Central Bank had to provide emergency loans to 10 percent of the banks. At the same time, government-controlled financial institutions—especially the Philippine National Bank and Development Bank of the Philippines—have expanded their lending dramatically to accommodate the government's acquisition of financially distressed firms, many of which were owned by political allies of Marcos. As a result, almost two-thirds of the Development Bank's assets are nonperforming, and the IMF estimates that this year the three largest government financial institutions will show a combined loss equal to about 2 percent of GNP. Financial reforms suggested by the creditors include merging some private banks, limiting new lending by government financial institutions, and relinquishing some of their functions to the private sector. [redacted] 25X1

25X1

Domestic Interests: Lobbying for Reform . . .

Reforms demanded by the aid donors are being strongly supported by Philippine business leaders, academics, and special economic interest groups. Well-publicized economic studies by Philippine academics and business organizations have concluded that a resurgent investment climate is required to

Philippines: Proposed Economic Reforms

Policies and Instruments	Expected Benefits	Remarks
Trade policies: • Lower tariffs. • Float exchange rate. • Decontrol foreign exchange allocations.	Stimulate export growth, eliminate the trade deficit, and allocate resources more efficiently. Nontraditional exports could increase by 9 percent annually; industrial output by 5 percent annually.	Central to ongoing World Bank structural adjustment loans (SAL), and IMF standby. Impact of SALs I and II—providing $500 million beginning in 1980—diluted by presidential decrees granting exemptions to Marcos's associates.
Fiscal policies: • Widen tax base, abolish distortionary taxes, and raise efficiency of tax collection. • Cut expenditures. • Prioritize investments. • Increase utility fees. • Reform public-sector corporations.	Balance the government budget, reduce reliance on foreign borrowings, and trim inflation. Establish public expenditure pattern consistent with long-term growth objectives. Eliminate subsidies to public-sector corporations.	Fundamental to the IMF adjustment program. Additional fiscal policy reforms planned for the World Bank's 1986 SAL III. Marcos and the ruling elite oppose budget cuts in favored programs and ministries as well as suspension of tax exemptions granted to close associates. Public is unhappy over increased utility fees for water, electricity, irrigation, and fuel.
Agricultural policies: • Decontrol input and farm-gate prices. • Decontrol crop marketing, especially in coconut and sugar. • Increase rural credit.	Raise agricultural output by over 4 percent annually by 1987, with growth rates of 4 percent for coconuts and rice and 2.3 percent for sugar.	Focal point of reforms advocated by World Bank and aid donors. Imelda Marcos and some technocrats favor continued government intervention in agricultural marketing, especially by the National Food Authority.
Financial institutions: • Rehabiliate government-owned financial institutions, limit new loans, and improve loan collections. • Merge and consolidate weaker private banks.	Strengthen financial sector and restore public confidence in banking system. Reduce reliance on foreign savings by raising domestic savings rate.	An action plan for financial reforms is required by IMF. Lending limits on government-owned banks resisted by technocrats favoring continued government acquisition of businesses and by ruling elite seeking financial bailouts.
Government decisionmaking: • Limit use of presidential decrees for setting economic policy.	Greater accountability and participation in policymaking. Reduced government intervention in economy and fewer special favors to Marcos associates.	One of the key political reforms sought by opposition parties, business community, and aid donors. Marcos is strongly resisting efforts to curb his decreemaking authority.

25X1

cope with rapid labor force growth and that agricultural reform is required to slow the expansion of the Communist insurgency. In addition, opposition parties in the National Assembly have launched investigations into Marcos's economic policies. In an unprecedented action, one subcommittee, seeking sweeping changes in the sugar industry, recently forced Benedicto to answer questions on corruption and mismanagement in NASUTRA. Moreover, special interest groups, such as the sugar planters and millers, are lobbying with some success; and in mid-1984 Marcos deregulated sugar exports, although NASUTRA retained control over the domestic market.

25X1

. . . Against Considerable Resistance

The key roadblock to the reform agenda is that it would undermine the structure of "crony capitalism"—the granting of loan guarantees, waived import taxes, and monopoly privileges—which has supported Marcos politically. Cojuangco, for example, uses his considerable influence to protect his economic privileges and to expand into new business ventures, such as cement, textiles, and food

processing. The cronies' financing, moreover, is particularly critical to supporting the activities of the KBL, the ruling political party, and underwrites the campaigns of favored politicians. [redacted]

Although Manila's technocrats continue to make strong statements supporting economic reform during their official meetings with creditors and aid donors, the US Embassy reports that, in private conversations, the leading technocrats—including Prime Minister Virata— do not appreciate the need for economic restructuring. They continue to blame external factors for the economy's recent poor performance and believe that the IMF stabilization program represents the lion's share of the reforms needed. [redacted]

Several developments suggest the technocrats do not take the aid donors' concerns seriously. For example, in response to the World Bank's insistence on an analytical study of the coconut and sugar sectors, the government prepared a paper defending the status quo. Furthermore, government officials are reluctant even to discuss politically sensitive topics such as reform of the National Food Authority and other government institutions that enjoy the protection of Imelda Marcos [redacted] Finally, although some senior government technocrats have opposed the crony empires, they are also committed to the government's own rapidly expanding role in the economy. [redacted]

Tough Course Ahead

There is little on the horizon to suggest a change in Manila's business-as-usual attitude. Marcos is preoccupied with domestic politics. We believe the policy changes he does approve are intended largely to placate domestic and foreign critics. Manila, for example, recently announced some reorganizations in the coconut and sugar sectors but, instead of consulting with the World Bank on a comprehensive set of reforms, as previously agreed, the government unilaterally developed and announced the reorganizations in a move likely to increase tensions with the Bank—its largest donor. Moreover, according to US Embassy reporting, the return of coconut trading to the private sector is widely viewed as lipservice to suggestions by the IMF and aid donors. They coconut plan- [redacted] works to his financial advantage and leaves the industry tightly controlled by the government. [redacted]

25X1

25X1

25X1

Resistance to reform is evident elsewhere. A looming crisis in the sugar sector—in which low world prices for sugar and a bankrupt NASUTRA threaten the jobs of over 250,000 workers—has prompted Marcos to announce that NASUTRA would be converted into a private firm. The arrangement, however, gives the new firm the sole right to market sugar—leaving open the possibility that Benedicto or another Marcos associate may control its board—and is viewed skeptically by most observers in Manila. [redacted]

25X1

25X1

For their part, the World Bank and IMF, with support from Manila's largest bilateral aid donors, appear determined to link increased future assistance to progress on economic reform. The IMF, in a departure from its traditional short-term adjustment program, has added structural reforms of taxes, public-sector investments, financial institutions, and agricultural marketing to the performance targets for the Philippines' $615 million standby loan. A larger portion of the World Bank's annual $500 million assistance program for the Philippines is now being linked to fundamental policy reform. In addition, Manila's commercial creditors are tying new financing to Manila's compliance with the targets and reforms of the IMF program. [redacted]

25X1

25X1

25X1

The government's sidestepping of significant economic restructuring so far suggests a lengthy confrontation between Manila and its aid donors. Manila has already missed the first performance target of the IMF adjustment program because it elected to seek lower interest rates—a popular move—rather than adhere to the tight money

supply targets set by the Fund. Additionally, Manila failed to submit a comprehensive action plan for coconut and sugar reforms in time for the Fund's March performance review. [redacted]

25X1

The delays and missed targets will postpone disbursements from the financial rescue package and risk significantly lower aid levels. As a result of missing the IMF's target for money supply, an $80 million drawing from the Fund, along with a $300 million disbursement from the commercial banks, will be postponed at least until May. Manila's lackluster approach to policy reform, moreover, has already led some donors to withhold or reduce new aid pledges at the annual meeting in January of the Philippine aid donors. To underscore their concern with policy reforms, a subcommittee of donors will meet with Philippine officials in April to review progress on structural and policy reform. [redacted]

25X1

25X6

Page Denied

Next 4 Page(s) In Document Denied

Proposed Soviet Gas Pipeline to Eastern Europe [redacted]

25X1

The Soviets are pushing for an agreement with East European countries on the joint construction of a new gas export pipeline. Moscow wants to get more East European participation in Soviet investment projects in return for increased Soviet deliveries of energy and other raw materials. It is not certain, however, that the East European nations could absorb the additional 20-22 billion cubic meters a year of gas that the pipeline reportedly would deliver. If not, the Soviets might attempt to sell some of it to Western Europe. [redacted]

Soviet Motivation

Moscow has for many years been trying to rectify what it considers to be inequities in its trade with Eastern Europe. Soviet assistance to Eastern Europe has taken the form of price subsidies, trade credits (as represented by chronic surpluses in trade), and Moscow's willingness to provide goods also salable for hard currency (such as oil and other raw materials) in exchange for goods not as salable. The Kremlin seems more determined than ever to reduce this assistance during the next five-year period. The Soviet approach is reflected in the October 1984 cooperation agreement with East Germany that calls on East Berlin to expand its capacity to produce equipment for the oil and gas industry as well as developing other sectors that would supply the USSR with needed goods and services. [redacted]

[redacted] in 1983 [redacted] the USSR was planning to build a new export pipeline to Eastern Europe during 1986-90. A Soviet announcement, in *Pravda* in July 1984 after the June summit of the Council for Mutual Economic Assistance (CEMA), indicated that the USSR—with the assistance of the East Europeans—would build a gas export pipeline to deliver 20-22 billion cubic meters a year to Eastern Europe. [redacted] the project will cost 10-13 billion rubles ($12-16 billion)—in contrast, CEMA's total investment projects in the 1986-90 period reportedly will come to about 45-55 billion rubles ($55-68 billion), of which the USSR will provide about half. [redacted] 25X1

25X1

Previously, the CEMA countries were extensively involved in the construction of the Druzhba (Friendship) oil pipeline in 1960-64 and the Soyuz (Union) gas pipeline in 1977-79. Each of the signatory nations to the Soyuz gas pipeline agreement was tasked with complete construction of a large segment of the line (including compressor stations), using its own resources and manpower. Western equipment and pipe purchased for the Soyuz pipeline was financed by $2.5 billion in syndicated loans raised by CEMA's International Investment Bank (IIB). These funds were then lent to East European countries, which, in turn, made them available to the Soviet Union. In addition, Eastern Europe provided substantial ruble assistance. East European contributions will be repaid with deliveries of resources and natural gas through 1990. [redacted] 25X1

25X1

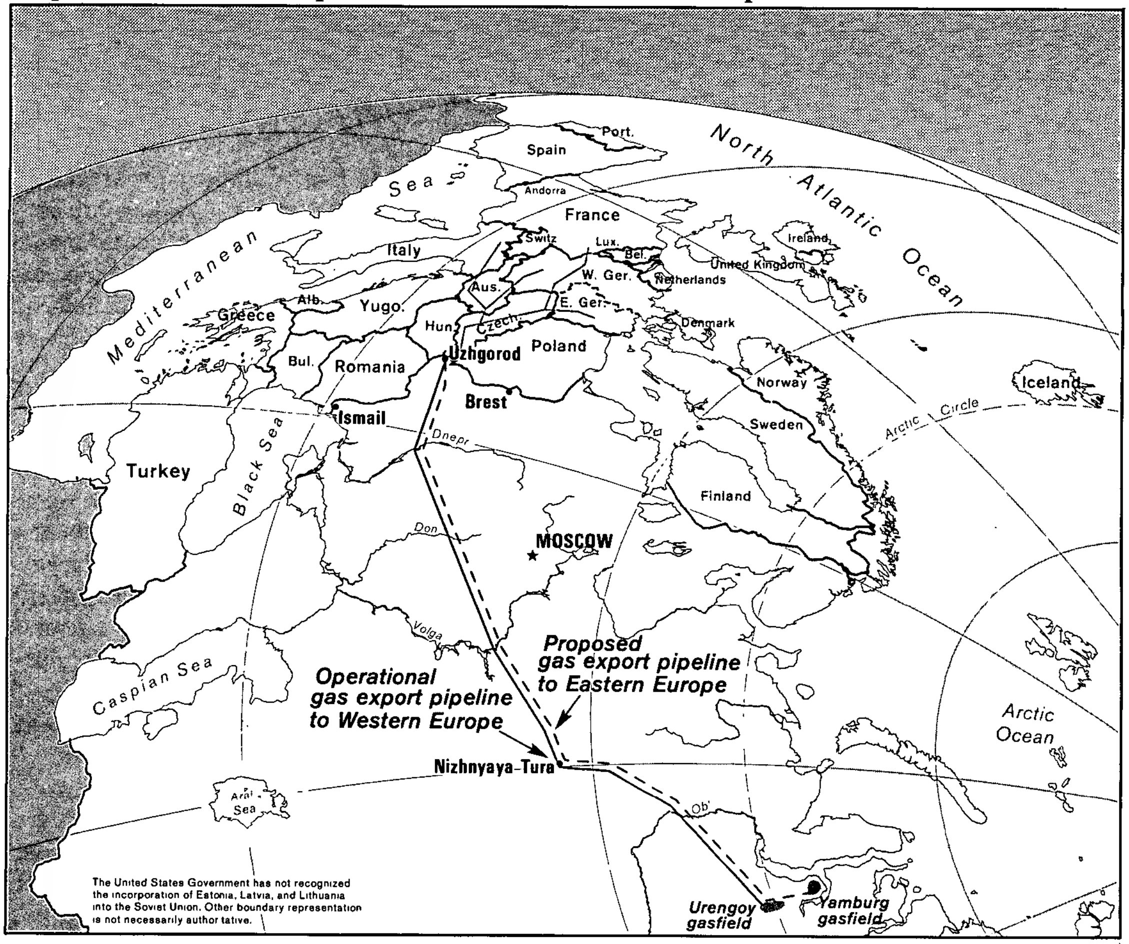
Requirements for Pipe and Equipment

The new export line will be about 4,600 km in length—two-thirds longer than the Soyuz line—and 1,420 mm in diameter. It reportedly is to have 40 compressor stations and run from the Yamburg gasfield, about 150 km north of the Urengoy gasfield, to the export terminal at Uzhgorod on the Czechoslovak border. The route will parallel the recently completed Siberia–to–Western Europe gas export pipeline. Construction reportedly will begin in 1985 and will be completed in 1988. [redacted]

25X1 25X1 25X1

Sanitized Copy Approved for Release 2011/03/02 : CIA-RDP97-00771R000707440001-0

Proposed Natural Gas Pipeline From Siberia to Eastern Europe



The Pipeline at a Glance

Length:	**4,600 kilometers (Yamburg-Uzhgorod)**
Capacity:	**32 billion cubic meters per year (gross); 26–28 billion cubic meters per year (net)**
Pipe:	**2.8 million tons, 1,420-mm (56-inch) diameter**
Operating pressure:	**75 atmospheres**
Total cost:	**10–13 billion rubles**
Completion:	**1988**

25X1

704336 2-85

We do not believe that the new CEMA gas export pipeline will be a major source of equipment contracts for West European firms as was the recently completed pipeline. [redacted] the USSR plans to use Soviet gas turbines. Output of Soviet turbines suitable for use on 1,420-mm gas pipelines has increased in recent years. Since the purchase of the 125 Western gas turbines for the Siberia–to–Western Europe gas export pipeline, the USSR has contracted to buy an additional 21 Western 25-megawatt turbines—enough to meet only about 10 percent of estimated demand during 1984-85. A substantial amount of the 2.8 million tons of high-grade, large-diameter pipe, however, will probably have to be imported from the West. [redacted]

East European Participation

Moscow apparently sees the gas pipeline as a high-priority project and is pressing to complete bilateral agreements with the individual East European countries. [redacted]

The East Europeans apparently are dragging their feet on the pipeline and other projects. [redacted]

In 1983 Soviet gas exports to Eastern Europe totaled about 31-34 billion cubic meters or about three-fifths of total gas consumption in Eastern Europe, excluding Romania.[1] [redacted] 25X1

Soviet Oil Deliveries to Eastern Europe 25X1

The new gas pipeline may be intended to compensate for possible reductions in Soviet oil deliveries to Eastern Europe. With oil output from the key West Siberian production region showing signs of slower growth and that from other production regions declining by about 10-12 million tons per year, Soviet oil output during 1986-90 at best will remain constant. Output in 1984 was 613 million tons—3 million tons below the 1983 level and 11 million tons below plan. At the annual CEMA meeting in October 1984, Soviet Premier Tikhonov announced that the USSR would continue "to guarantee oil supplies" to CEMA member nations and "increase future shipments" of electricity and gas. The wording of the Soviet announcement suggests that, although the USSR will continue delivering oil to the CEMA countries, the volume of future oil shipments may be reduced. [redacted]

25X1 25X1 25X1

Western Europe: An Alternative Market?

It is uncertain whether the East European countries will have the pipeline network and industrial facilities to distribute and absorb annually the additional 20-22 billion cubic meters of gas to be delivered annually by 1990. Even if the East European economies could absorb the planned amount, the

[1] We are unable to determine precisely how much Soviet gas was delivered to Eastern Europe in 1983. Soviet trade data indicate a 23-percent increase in the ruble value of gas deliveries, which would suggest total deliveries to Eastern Europe of 34-35 billion cubic meters at constant prices, excluding Romania. [redacted] 25X1

25X1

pipeline would still have some capacity for additional gas exports to Western Europe. Soviet technical journals indicate that the net throughput of a pipeline of this length and diameter operating at a pressure of 75 atmospheres is about 27 billion cubic meters per year—5 to 7 billion cubic meters more than the amount of gas that the Soviet press reports is earmarked for Eastern Europe. Eastern Europe's ability to absorb Yamburg gas depends also on the amount of Soviet gas received through other pipelines. Press reports indicate plans to build a gas pipeline from the Soviet border at Brest to Warsaw in 1985. Another gas pipeline will reportedly be laid from the Soviet export terminal at Izmail to Bulgaria. (Some of the gas transported through this pipeline, however, is probably earmarked for Turkey.) 25X1

If West European gas demand rises more than is currently expected during the late 1980s and early 1990s, the Soviets could use the excess capacity of the proposed line to Eastern Europe as a ready-made vehicle to transport gas to Western Europe. This could be of substantial help in maintaining total Soviet hard currency exports at a time when its oil exports may be declining. The outlook for such sales to the West would, of course, depend on energy market conditions and the willingness of prospective Western buyers to become more dependent on Soviet gas. We believe that current European industry and government forecasts for West European gas demand may be understated and do not take into account an apparent return to higher rates of economic growth. 25X1

Cuba: Castro Struggles With the Economy [redacted]

25X1

President Castro's recent call for new economic priorities and at least another 15 years of austerity reflect Cuba's concern over mounting financial problems as well as its sensitivity to sharp Soviet criticism of Havana's economic mismanagement. The regime's new emphasis on meeting debt obligations to and improving trade balances with the Soviet Bloc and the West also suggests that economic pragmatists have reemerged as the predominant element in the leadership. The austerity measures needed to meet Havana's overambitious trade targets will be a severe blow to Cuban consumers whose expectations have been fed by moderate economic growth during 1984 and by optimistic rhetoric. Although Havana's trade goals will require Castro to project an image of responsibility and moderation in the West, we do not anticipate any change in the regime's distrust of and antipathy toward the United States, nor any fundamental shift in Cuba's relations with the Soviet Union. [redacted]

Growing Economic Pressures

After two years of tightened austerity under the guidance of its Western creditors, Havana apparently gambled in 1984 that a burst of spending on imports and government construction projects would increase employment, soothe growing popular discontent and divert attention away from its recent foreign policy blunders. By the middle of last year, however, it was apparent that slack export demand and domestic economic bottlenecks were foiling Havana's recovery effort. At best, the experiment produced a moderate increase in short-term economic growth at the cost of erasing the hard currency trade surplus and precipitating sharp criticism from Western and Soviet creditors. [redacted]

25X1

Cuba: Hard Currency Current Account *Million US $*

	1980	1981	1982	1983	1984 [a]
Current account balance	**−67**	**64**	**359**	**237**	**−128**
Trade balance	517	364	727	511	32
Exports, f.o.b.	1,759	1,799	1,627	1,431	522
Imports, f.o.b.	1,242	1,435	900	920	490
Services balance	−584	−300	−368	−274	−160

[a] First six months.

[redacted] 25X1

We estimate that the real growth of the Cuban economy was closer to 3 percent last year than the 7.4 percent claimed by the Cuban Government—a figure 2 percentage points higher than the official target. Havana has historically ignored or underestimated the impact of domestic inflation.[1] According to official statistics, growth was driven by a record increase in construction—apparently stimulated by government investments in transportation and city planning projects. Shortfalls in sugar, citrus, and nickel production—Cuba's leading export earners—contributed to Havana's apparent failure to meet its economic growth target for 1984. [redacted]

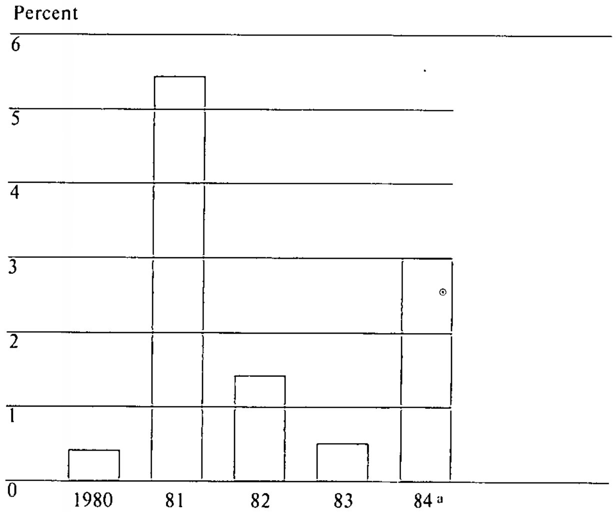
25X1

25X1

[1] The US Interests Section in Havana estimates that the cost of living rose about 7 percent last year—almost 5 percentage points higher than the figure implicit in official Cuban statistics. [redacted]

25X1

Cuba: Real Economic Growth, 1980-84

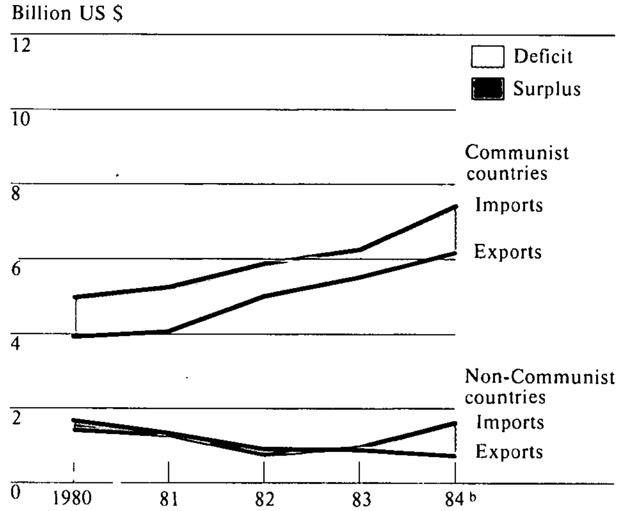


a Preliminary.

305058 3-85

25X1

Cuba: Foreign Trade[a], 1980-84



a Projected, based on trade patterns over the first six months of 1984.

b Cuban trade with non-Communist countries is based on hard currency world prices, while most of its Communist country trade uses soft currency–negotiated prices that are frequently subsidized in Cuba's favor and do not reflect real market values. The result is a more favorable global trade balance than if Cuba conducted all of its trade at world market prices.

25X1

305059 3-85

Havana claims that increased worker productivity accounted for 60 to 80 percent of its economic growth. This claim reflects the government's effort to spotlight the success of highly touted incentive programs introduced into roughly half of all economic establishments over the past two years. In reality, Cuba's economic growth last year probably was more the result of a sharp increase in imports that allowed a short-term rise in local production. During the first half of last year, imports from the Soviet Bloc rose 19 percent, and those from the West jumped 69 percent, probably largely the result of an expanded line of credit from Argentina and the resumption of government-guaranteed export insurance from Japan. Past trends and official policy suggest that more than half the imports from the West consisted of raw materials and intermediate goods that would have contributed directly to domestic output.

25X1

Havana's Economic Management Under Fire

25X1

Cuba's economic performance was also being scrutinized by Cuban economists and Western creditors. According to the US Interest Section, Cuban economists warned that the government's assertions regarding economic growth should be adjusted downward to reflect reality. Commercial and Western government creditors—kept relatively well informed of Cuba's freewheeling spending on imports—will likely make their concerns known as negotiations over the rescheduling of Cuba's 1985 debt get under way later this spring.

Little Improvement in Sight

Cuba almost certainly will be unable to repeat this year the moderate economic growth achieved in 1984. Soviet economic assistance has leveled off over recent years. Cuban press reports indicate that, despite Havana's vigorous lobbying, Cuba received little assurance of any real increase in aid from its Soviet and East European benefactors at the annual CEMA head of state conference in October. Nor was the outlook for new lending from Western creditors bright. Official statistics released last fall indicated that Havana was falling short of meeting yearend targets for hard currency trade and reserves set by official Western creditors as conditions to any further debt rescheduling.

The outlook for hard currency export earnings at the end of 1984 indicated that Havana would be hard pressed to fund increasing levels of Western imports over the near term:

- World sugar prices are projected to remain near record lows through much of 1985 owing, in part, to the disintegration of the International Sugar Agreement in December 1984 and massive world sugar stocks.

Soviet Assistance to Cuba *Million US $*

25X1

1980	3,463
1981	4,558
1982	4,666
1983	4,215
1984	3,750 [a]

[a] Projected.

25X1

- The inferior quality of Cuban citrus and contracts obligating the bulk of the crop to the Soviet Union and Eastern Europe will limit hard currency citrus earnings. 25X1

- Despite Havana's hopes for increased nickel production as new factories are brought on line, hard currency nickel earnings will be limited by a continued weakness in the world market price and by US agreements with Japan and several West European nations prohibiting the sale of steel containing Cuban nickel to the United States.

Furthermore, with no promise of increased Soviet petroleum, Havana undoubtedly realizes that its ability to resell surplus Soviet petroleum for hard currency and to support the demands of new factories—particularly in the energy-intensive nickel sector—will require strong energy conservation measures. 25X1

25X1

Economic War Declared

In several recent speeches, Castro responded to these building pressures by declaring a "profound economic revolution" against waste and inefficiency. The Cuban president called for discussions to be

held in every workplace on a set of new economic priorities:

- Increase nonsugar exports to the West by at least 20 percent.
- Meet export commitments to the Soviet Bloc.
- Limit import spending.
- Honor debts from Western and Soviet creditors.

[redacted]

Havana has released only sketchy information on how it will meet its new goals. Cuban economists probably have run up against considerable trouble in detailing any implementation scheme. We believe, however, Havana's targets are unrealistic and often contradictory:

- Havana's overambitious plan to boost hard currency export earnings will be limited by the need to meet CEMA trade quotas; by Soviet insistence that Cuba concentrate on the production of traditional, yet depressed, exports such as sugar; and by the difficulty of conserving petroleum for resale.

- Despite the goal to limit total import expenditures, Castro has publicly admitted that Cuba will need increased levels of Western inputs to production in order to support economic growth this year.

- With the uncertain outlook for export earnings, and the unlikelihood of substantial new trade credits, Havana probably will have insufficient hard currency reserves to pay for these Western inputs. [redacted]

In our judgment, implementation of Castro's plan will hold growth well below the 4.5- to 5.0-percent target for 1985. Planned cuts in government spending for construction and social service projects, together with energy rationing, will dampen economic activity. Havana will have to push sugar production if it is to meet export commitments to the Soviet Bloc and still maintain sales to hard currency markets. [redacted] Havana has lowered its sugar production target this year, because of the extended cane cutting season last year, unseasonable rainfall, and a shortage of Western herbicides. [redacted]

Impact on the Consumer

The Cuban population will bear the brunt of the new austerity. The simultaneous drive to cut imports and increase exports will reduce domestic consumption; the production and importation of consumer goods have become Havana's lowest priorities. [redacted] 25X1

25X1

Castro's warning that Cuba faces at least another 15 years of economic hardships is a severe blow to the long-suffering Cuban whose rising expectations have been fed by recent moderate economic growth and optimistic rhetoric. Moreover, new regulations to stimulate productivity—such as longer working hours and the relocation of workers from inefficient factories—are likely to add to popular discontent. [redacted] 25X1

In an apparent attempt to mollify the populace, Castro already has assured Cubans that there will be no decline in current living standards. Havana is likely to dangle the possibility of emigration to the United States under the recent bilateral agreement as a means of temporarily quieting critics.[2] Havana may also loosen some economic controls, such as it did recently with a new housing law that allows private ownership and leasing of real estate. Measures such as the housing law, however, carry the danger of unleashing long pent-up expectations for additional reform. Civil disobedience is almost certain to increase. As it has in the past, the regime likely will resort to repressive tactics. [redacted] 25X1

25X1

Implications for the United States

If past patterns hold true, Cuba's current swing toward more pragmatic economic policies will have a major impact in terms of tactics and focus, but not in ultimate goals. Havana is placing great stress on developing diplomatic, commercial, and cultural

[2] The United States and Cuba reached agreement last December to return to Havana approximately 2,700 "undesirable" refugees and to allow up to 30,000 Cubans to emigrate to the United States annually. [redacted] 25X1

25X1

25X1

25X1

Pragmatists in Charge

The remedial measures Castro has endorsed for the Cuban economy suggest a revitalization of the influence of individuals in the leadership who, over the years, have argued for more pragmatic policies to alleviate both domestic and international problems. These pragmatists, who are responsible for the day-to-day functioning of the economy, see increased contacts and trade with the West as well as material incentives as necessary evils to overcome worker apathy and boost productivity.

In policy deliberations, the pragmatists compete with the hardliners, who head the military and security establishments. They view permanent confrontation with the West as necessary to prevent ideological contamination and insist that only moral incentives are ideologically acceptable. 25X1

As a confirmed revolutionary, Castro clearly prefers the dramatic activism advocated by the hardliners. Economic reality, however, especially when reinforced by pressure from Moscow, has forced him to pay greater heed to the pragmatists in the past. A measure of the pragmatists' recent success can be found in the ease with which the new housing law was approved by the National Assembly. Recently, several hardliners who appear to have strongly resisted even temporary ideological backtracking have lost their posts or been demoted. 25X1

ties with Western nations in a program aimed at developing new markets and increasing Cuban exports. To promote these ties, Castro has donned the cloak of peacemaker and is relying on his formidable persuasive skills to refurbish Cuba's—and his own—image in Western Europe, Latin America, and the United States. He has already been able to convince a steady stream of Western visitors to carry his message abroad that he is willing to negotiate virtually any differences Cuba may have with any country, especially the United States. 25X1

Although the pressures on Castro probably will make him more amenable to negotiate solutions to less critical bilateral matters—a new antihijacking agreement, for example—they will not alter his basic antipathy and distrust of the United States. Moreover, he cannot relax his overt hostility towards Washington without the risk of feeding popular expectations that an imminent improvement in relations with the United States will bring immediate economic relief. He wants no such internal pressure that might limit his policy options. 25X1

25X1

LDC Financial Developments: Monetary Data as an Early Warning

25X1

Since late 1982, the international financial community has had substantial data on countries undertaking IMF-supported programs, but financial information on other LDCs, especially up-to-date balance of payments and fiscal data, is more limited. Central bank data, however, appear to be good indicators of changes in domestic and external financial conditions and as evidence of policy behavior in financially troubled countries.[1]

According to these indicators, Colombia's domestic and external financial condition is deteriorating rapidly and, in the absence of strong adjustment measures, probably will soon lead to a rapid increase in inflation and a foreign exchange crisis. The indicators also suggest that the deterioration in Algeria, India, and Pakistan may warrant closer attention. Some countries, however, are showing substantial improvement in their financial conditions, in particular Indonesia.

Financially Deteriorating Countries

According to the methodology, Colombia has experienced the most serious deterioration of the 11 countries. Starting in early 1983 net foreign assets of the central bank declined rapidly, and net domestic assets increased. The monetary base also rose but at a less rapid rate. This information implies that the Colombian Government has been running a large fiscal deficit that is being heavily financed by the central bank. The data also indicate that the central bank was intervening heavily in the foreign exchange market to reduce the inflationary growth of the monetary base. If the

[1] We used the methodology to examine Algeria, Bangladesh, Colombia, Egypt, India, Indonesia, Malaysia, Pakistan, Thailand, and Venezuela, countries that do not have an IMF program but who are potentially troubled debtors; in addition, South Korea was included.

Methodology

Data on central banks—contained in the IMF's International Financial Statistics (IFS)—can be arranged into the monetary base, net domestic assets, and net foreign assets. Changes in these categories can then serve as an indication of developments in domestic and external economic performance, especially for countries suspected of having potential balance-of-payments problems. For example:

- *A rapid increase in net domestic assets indicates the central bank is heavily financing government deficits.*
- *Rapid declines in net foreign assets may indicate a balance-of-payments deficit.*
- *Rapid rises in the monetary base suggest the central bank is running an expansionary domestic policy that will lead to a rapid increase in the money stocks and, eventually, inflation.*

On the other hand, a rise in net foreign assets combined with stability in the monetary base and stability or declines in net domestic assets indicates a relatively strong position such as would occur with a current account surplus and a small budget deficit.

Financial analysts using this methodology need to be wary about forming conclusions based only on these data. Other factors such as the competitive value of the exchange rate and major changes in foreign exchange and credit restrictions may distort the indicators. Another drawback is that a few countries submit their central bank data only after a considerable lag.

25X1

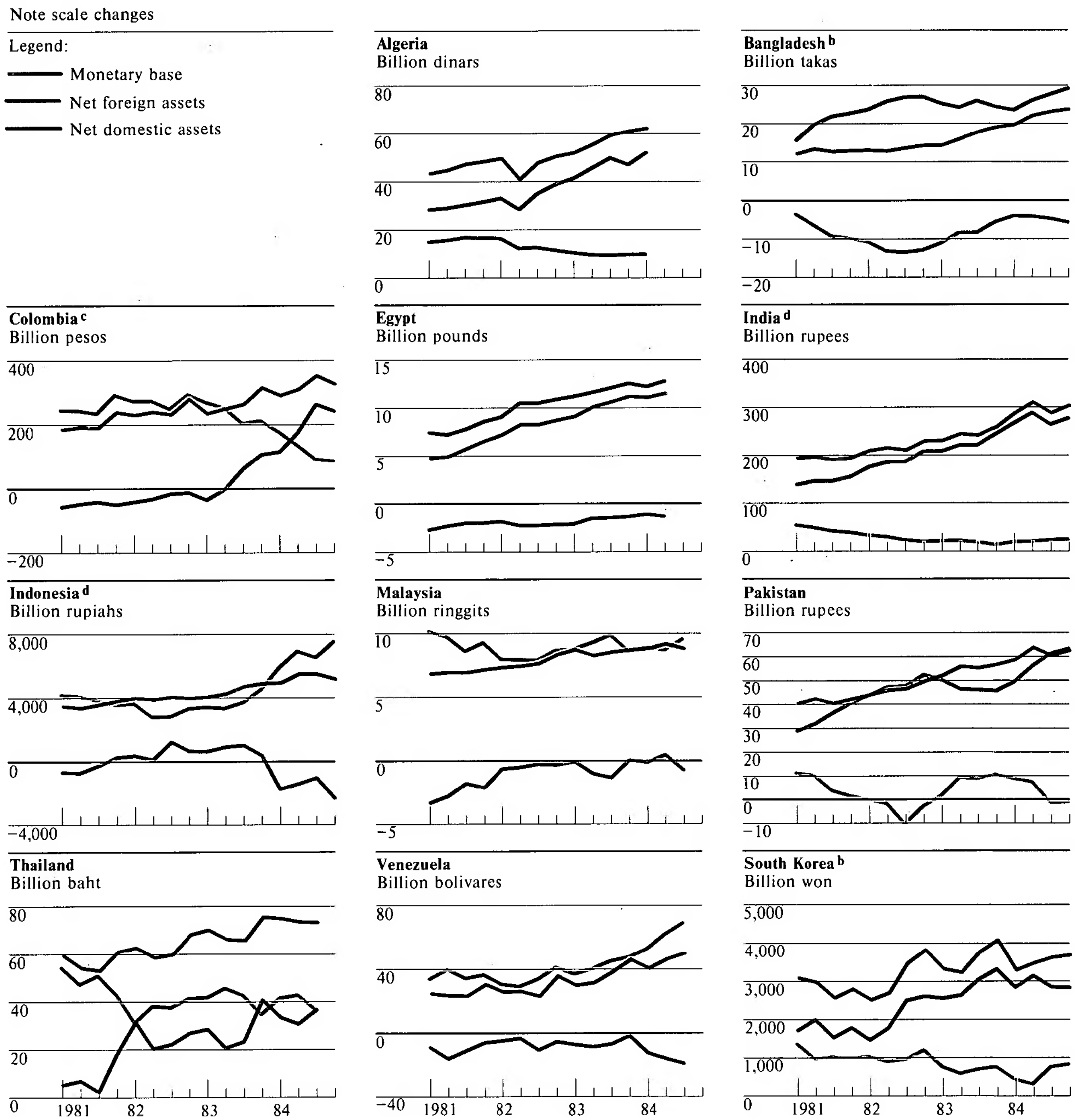
25X1

25X1

25X1

25X1

LDC: Financial Performance[a], 1981-84



[a] The classification of net domestic assets and net foreign assets may differ from those stipulated in an IMF program.
[b] Fourth quarter 1984 based on October 1984 data.
[c] Third- and fourth-quarter 1984 data estimated.
[d] Fourth quarter 1984 based on November 1984 data.

25X1

305044 3-85

central bank eventually exhausts its foreign exchange reserves—and these declined sharply in 1984—any additional deficit financing by the central bank would lead to a rapid increase in the monetary base, a subsequent rise in the inflation rate, and a likely balance-of-payments crisis.

The data on India and Pakistan indicate that both countries experienced a deterioration during late 1981 through the third quarter of 1982. The deterioration in India then slowed until the third quarter of 1983, and Pakistan's external and domestic financial situation improved until fourth quarter 1983. According to the indicators, however, financial deterioration in both countries resumed in 1984.

The information on Algeria indicates that starting in mid-1982 the government's budget deficit was heavily financed by the central bank, causing the monetary base to grow rapidly. At the same time, the central bank intervened in the foreign exchange market through purchases of its own currency. The data indicate, however, that Algeria undertook some adjustment measures in late 1983 that helped alleviate the necessity of central bank purchases of government debt.

Financially Improving Countries

According to the indicators, Indonesia and Venezuela have demonstrated substantial improvement in their domestic and external finances over the past few years. Indonesia's improvement was the most spectacular. Starting in early 1983, Indonesia implemented adjustment measures including devaluing its currency, reducing the public-sector deficit, and enacting more market-oriented policies. These measures led to a rapid inflow of foreign exchange. The central bank largely neutralized the inflationary impact of central bank purchases of foreign exchange through sales of government debt.

The data on Venezuela indicate an improvement in domestic and external finances in 1983-84 following some deterioration. During 1983 the government devalued the currency and substantially reduced the public-sector deficit, which led to an inflow of foreign exchange and alleviated the need for central bank financing of the public-sector deficit.

Other Country Situations

The economic indicators for Bangladesh, Egypt, Malaysia, South Korea, and Thailand did not indicate any strong trend. The data on Bangladesh show that the government was heavily financing its fiscal deficit through the central bank during 1981 and early 1982; however, the deterioration was halted in mid-1982. In Egypt, the monetary base and net domestic assets of the central bank have been growing at a rapid rate since early 1981, but net foreign assets of the central bank have been fairly stable. The data on South Korea and Thailand have fluctuated greatly over the past three years, but no long-term trend is discernible. Conversely, the indicators on Malaysia have fluctuated little.

25X1

Page Denied

Sanitized Copy Approved for Release 2011/03/02 : CIA-RDP97-00771R000707440001-0